

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**



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Order Instituting Rulemaking in the Review)
of the California High Cost Fund B Program) R.06-06-028
_____)

**COMMENTS OF SPRINT NEXTEL
ON ASSIGNED COMMISSIONER'S RULING
REGARDING THE SCOPING AND SCHEDULING OF PHASE II ISSUES**

Introduction

Pursuant to the October 19, 2007 electronic mail ruling of the Assigned Administrative Law Judge, Sprint Communications Company, L.P. (U 5112 C), Sprint Telephony PCS, L.P. (U 3064 C), Sprint Spectrum L.P. as agent for Wireless Co., L.P. (U 3062 C) *dba* Sprint PCS, and Nextel of California, Inc. (U 3066 C) (collectively, "Sprint Nextel"), respectfully submit these Comments on the issues specified in the October 5, 2007 Assigned Commissioner's Ruling Regarding the Scoping and Scheduling of Phase II Issues ("the ACR") in the above-captioned proceeding.

The ACR solicits comments on a wide range of important issues. The manner in which the Commission resolves these issues will have a lasting impact on competition in California's telecommunications markets for the next decade and beyond. If the Commission properly resists undue concerns about increases in the price of "basic service" in alleged "high cost" areas,¹ it will guarantee that *all Californians benefit* from the full play of competitive market forces. If, however, the Commission fails to remove existing price caps on "basic service" as of January 1, 2009, it will deprive Californians of the benefits of economic efficiency envisioned in the *Phase I URF Decision*.² The Commission should take care to avoid such a result.

¹ All references herein to "basic service" are to basic flat or measured rate residential local exchange service. Any references herein to "high cost" areas merely reflect incumbent local exchange carrier ("ILEC") claims, and do not constitute Sprint Nextel's agreement, that some areas of California are more costly for ILECs to serve than others.

² *Order Instituting Rulemaking on the Commission's Own Motion to Assess and Revise the Regulation of Telecommunications Utilities*, R.05-04-005, Opinion [D.06-08-030] (2006) __ CPUC 2d __, 2006 Cal. PUC LEXIS

Summary of Conclusions

In the Comments that follow, Sprint Nextel urges the Commission to adopt the following conclusions:

- The California High Cost Fund-B (“CHCF-B”) program is no longer necessary.
- Continuation of the CHCF-B program as it is presently constituted would be anticompetitive and harmful to both carriers and, especially, consumers.
- The CHCF-B Program should be allowed to expire as of January 1, 2009.
- Therefore, the Commission does not need to “update” the existing, long-out-of-date cost proxies it developed in 1996 for identifying supposed “high cost” areas in California.
- The Commission therefore need not devote resources for attempting such an “update” through use of the HM 5.3 Model.
- In addition, the Commission need not conduct a “reverse auction” to identify carriers of last resort (“COLRs”) to provide service in the supposed “high cost” areas.
- Competition at the retail level is sufficiently vigorous that the Commission no longer needs to impose price caps on basic residential local exchange service (“basic service”).
- Continued imposition of price caps on basic service will result in inefficient outcomes that are harmful to consumers and to California’s economy as a whole.
- Thus, the Commission should remove all price caps on basic service as of January 1, 2009.
- The Commission should immediately modify eligibility restrictions for both the Universal Lifeline Telephone Service (“ULTS”) program and, to the extent it continues, the CHCF-B program so that wireless and other intermodal carriers are eligible to

367 (“Phase 1 URF Decision”), *modified and limited rehearing granted and rehearing otherwise denied* [D.06-12-044] (2006) __ CPUC 2d __, 2006 Cal. PUC LEXIS 511.

participate in and receive subsidy funds under these programs on a competitively neutral basis.

- The Commission should ensure that both the ULTS program and, to the extent it continues, the CHCF-B Fund program are conducted and operated on a competitively neutral basis, without any continuing bias in favor of the ILECs.
- The Commission should not underestimate the difficulties it faces in attempting to conduct a reverse auction to determine the “winner” of support in alleged “high cost” areas; there are many complex issues on which the Commission must provide the parties with guidance before they can assist the Commission in designing a reverse auction.
- The Commission should be cautious regarding the extent to which the HM 5.3 Model can reliably be used for determining the cost of basic service in high cost areas.
- The Commission should ensure that both the Division of Ratepayer Advocates (“DRA”) and the Communications Division (“CD”) have access to HM 5.3 Model experts for proper assessments of the ILECs’ attempted use of that model in this proceeding.
- The Commission should clearly state, prior to conducting a reverse auction or attempting to use the HM 5.3 Model to determine new cost proxies for high cost areas in California, that the annual total cost of the CHCF-B program, for all participating carriers, will not exceed \$119.2 million under any circumstances.

Prefatory Statement

As explained in the attached Declaration of Sprint Nextel economist Chris Frentrup,³ the Commission should not expect, and need not fear, that basic service rates will experience significant increases if the Commission eliminates existing price caps as of January 1, 2009. The pressure of competition from independent, non-ILEC affiliated wireless and cable-based carriers,

³ Mr. Frentrup’s Declaration is attached as Exhibit 1 to these Comments.

as well as from Voice over Internet Protocol (“VoIP”)- and unbundled network element (“UNE”)-based carriers, will effectively prevent ILECs from trying to impose significant basic service rate increases, even on a geographically deaveraged basis, in alleged high cost areas.

The Commission should discontinue all subsidies for networks, companies and services, whether “basic” or “broadband” or anything in between, as of January 1, 2009. Individual *customers* who are eligible, on a means-certified basis, for Lifeline support should be able to claim a “universal service” subsidy and then spend it on whatever basic service (regardless of the identity of the provider⁴) they find best meets their basic telephone service needs. This will ensure that Lifeline customers, too, enjoy the full benefits of competition. With comparatively minor modifications, the Commission’s existing ULTS program could accomplish this purpose. The ULTS program will help ensure that those who need help and can qualify for assistance will get it, and those who do not require financial assistance will not receive inefficient subsidies.⁵ If the Commission continues the ULTS program, it need not fear that eliminating subsidies embedded in archaic and heavily skewed rate design structures will undermine continued achievement of universal service goals in California.

Due to innumerable changes in technology and in the marketplace since the Commission issued the *Universal Service Decision*⁶ in 1996, there no longer is a need or any justification for a

⁴ One limitation, however, would likely be necessary. To ensure that customers that obtained such a means-tested subsidy were getting the services they paid for, any such subsidy would have to be spent only on basic service provided by carriers subject to the jurisdiction of the Commission. These could be wireline carriers (including Voice over Internet Protocol (“VoIP”)-based carriers) with certificates of public convenience and necessity (“CPCNs”) issued by the CPUC, wireless carriers authorized to provide wireless services by the Federal Communications Commission (“FCC”), or VoIP-based carriers that do not have CPCNs issued by the CPUC but which agree to be subject to the CPUC’s jurisdiction for purposes of a reverse auction or the CHCF-B and/or ULTS programs. The Commission should hesitate to exclude carriers simply because they do not utilize traditional wireline technology. Wireless carriers authorized by the FCC to provide wireless services would be neither more, nor less, subject to the CPUC’s jurisdiction than they are today.

⁵ Subsidies should also continue to be available for eligible customers under the Commission’s deaf and disabled telecommunications program (“DDTP”).

⁶ *Rulemaking on the Commission’s Own Motion into Universal Service and to Comply with the Mandates of Assembly Bill 3643*, R.95-01-020; *Investigation on the Commission’s Own Motion into Universal Service and to Comply with the Mandates of Assembly Bill 3643*, I.95-01-021; Opinion [D.96-10-066] (1996) 68 CPUC 2d 524, 1996 Cal. PUC LEXIS 1046 (“*Universal Service Decision*”).

High Cost Fund in California.⁷ In 1996, the ILECs faced no competition whatsoever. Now, more than a decade later, as the *Phase 1 URF Decision* recognized, retail competition is vigorous and widespread.⁸ ILECs no longer have the ability to impose or sustain supra-competitive retail rate increases anywhere in California. The Commission should terminate the CHCF-B program and eliminate all price caps on basic service as of January 1, 2009. With appropriate consumer education messages provided well in advance of that date, all ratepayers will be able to quickly adjust to the new reality without dislocation, inconvenience, or loss of telephone service.

The corollary to the points above is equally clear. If the Commission elects, mistakenly, not to terminate the CHCF-B program as of January 1 (or June 30), 2009, it should ensure that future CHCF-B program expenditures, if any, cannot and do not exceed an annual program cost of \$119.2 million (as of June 30, 2009) as envisioned in Decision (D.)07-09-020.⁹ Having made a long overdue 75% correction to the burgeoning \$435 million CHCF-B Fund program in D.07-09-020, the Commission should not allow the CHCF-B program to grow back to its previous size, or anything close to it. Whether the Commission relies upon a “reverse auction” or new HM 5.3 Model-based proxies to estimate the cost of providing service in alleged high cost areas, the total high cost program should not exceed the currently expected \$119.2 million level. The Commission should keep in mind at all times that the CHCF-B surcharge is a tax on all for the alleged benefit of a few – a comparatively few ILEC customers who *choose* to live in areas with

⁷ See “Comments of Sprint Nextel in Response to the Assigned Commissioner’s and Administrative Law Judge’s Ruling Soliciting Further Comments,” filed April 27, 2007, available at: <http://www.cpuc.ca.gov/EFILE/CM/67258.pdf>, where Sprint Nextel detailed its view that the “high cost fund” is no longer necessary due to, *inter alia*, the widespread availability of low-cost, high quality wireless services in “high cost” areas and other recent technological developments.

⁸ As Sprint Nextel has previously emphasized to the Commission, while there is vigorous and effective competition *at the retail level*, there is a striking lack of effective competition at the wholesale level. ILEC switched and special access service prices, for example, seem to be permanently fixed at bottleneck monopoly levels that are many times greater than economic (long run incremental) cost. The fact that ILEC competitors, such as Sprint Nextel, still must pay such prices should be kept in mind as the Commission resolves the issues in the ACR.

⁹ *Order Instituting Rulemaking into Review of the California High Cost Fund B Program*, R.06-06-028, Interim Opinion Adopting Reforms to the High Cost Fund-B Mechanism [D.07-09-020] (2007) __ CPUC 2d __, 2007 Cal. PUC LEXIS, *app. for reh. pending* (filed October 9, 2007, by The Utility Reform Network (“TURN”)).

allegedly high telecommunications service costs for the sake of the numerous economic, social and/or environmental benefits such areas provide.¹⁰ Such customers should not be seen as “victims” who need special subsidies just because they happen to be fortunate enough, for example, to live near Mount Shasta or Lake Tahoe or in other scenic areas of California.

To the extent that the Commission intends, in the short run, to rely upon HM 5.3 Model-generated costs to generate high cost subsidy figures, the Commission should ensure that the CD and DRA have appropriate support from experts thoroughly familiar with that model. Sprint Nextel has little doubt that the ILECs will attempt to bury the Commission and its staff in claims that the cost of providing service in rural areas is “greater than ever.” Parties that lack the ILECs’ deep pocket resources will be unable to match the ILECs’ showing in a “cost study” proceeding. The Commission should prepare for this possibility by arming both CD and DRA with all the resources they need to save California ratepayers from inflated cost claims.

Allowing the ILECs to recover highly inflated costs from the “high cost” fund would be just as harmful to California’s economy as continuing to cap basic service prices. By stating, in advance, that the total cost of any high cost program cannot exceed the currently envisioned annual program cost of \$119.2 million, no matter how the total subsidy amount is calculated, whether by auction, HM 5.3 model, or otherwise, the Commission will significantly temper any incentives the ILECs may have to submit inflated cost claims. A cap on the overall size of the high cost program will properly cause the ILECs to dispute each other’s showings, as each seeks to obtain its own slice of a “fixed pie.” If it does not allow the CHCF-B program to sunset as of

¹⁰ The Commission should also keep in mind that the CHCF-B program is funded in part by the customers of the ILECs’ competitors, which are compelled to incur, without reimbursement, the not insignificant costs of collecting, remitting and accounting for the CHCF-B surcharge. In few, if any, other areas of the economy are some companies forced to subsidize, at their own expense, the operations of their competitors – especially competitors that now offer a host of new revenue-generating services that did not even exist when the subsidy was first conceived. Although this effect would also be present with any continuation of the ULTS program, at least with the ULTS program subsidies are targeted to customers on a means-tested basis and therefore, at least theoretically, are no larger than necessary. In contrast, the CHCF-B program subsidizes all customers in an alleged high cost area, whether they need such subsidies or not, which exacerbates its anticompetitive impact.

January 1, 2009, the Commission should steadily shrink and then finally eliminate this program as quickly as possible, even in areas where the cost of providing basic service today supposedly exceeds the \$36 benchmark adopted in D.07-09-020.¹¹ By structuring the future of this proceeding in this manner, the Commission can negate the ILECs' inherent, overwhelming advantage when it comes to conducting HM 5.3 cost studies.¹²

Discussion

I. REVERSE AUCTION DESIGN AND IMPLEMENTATION ISSUES

In the comments that follow, Sprint Nextel addresses the questions identified in Section 2.1 of the ACR. By way of introduction, in lieu of attempting, by itself, to design a reverse auction, Sprint Nextel offers general direction on the parameters of an appropriate reverse auction.

1. Are there any statutory limitations to designating COLRs through an auction process?

With regard to continuation of the CHCF-B Fund program which Sprint Nextel opposes – the principal limitation that the Commission faces at this time is the impending expiration of the Commission's statutory authority to operate a "high cost" support program at all. Public Utilities Code Section ("PU Code §") 739.3 expires at the end of 2008.¹³ Unless PU Code 739.3 is reenacted, the Commission will have to consider whether it has the authority required to conduct a CHCF-B Fund or similar program.¹⁴ In the event that PU Code § 739.3 is not

¹¹ See *id.* at 40-53 (adopting \$36 benchmark).

¹² The Commission should keep in mind that the parties that developed the HM 5.3 Model for use *against* the ILECs, AT&T (*i.e.*, "old" AT&T) and MCI, are now owned by the ILECs (*i.e.*, "new" AT&T and Verizon). The chance that any party could effectively contest the ILECs' ability to manipulate the HM 5.3 Model is correspondingly small.

¹³ See PU Code § 739.3, subd. (f).

¹⁴ The Commission may believe it has such authority, either inherently or under PU Code § 701 (permitting the Commission to do all things "necessary and convenient in the exercise of [its] power and jurisdiction"). Fundamentally, however, this statutory provision merely begs the question whether a CHCF-B Fund-type program is within the Commission's "power and jurisdiction" in the absence of specific legislative authority. It would be

renewed, the Commission should not attempt to operate a “high cost fund” program without legislative authorization. If the Legislature has not extended the life of this statute, it means that the CHCF-B Fund program should be brought to an end.

Even assuming that PU Code 739.3 is reenacted, without change, to extend its expiration to some later date, the Commission would still face important restrictions until this section eventually expires. The program for assisting carriers of last resort (“COLRs”) must be “suitable, competitively neutral, and broadbased” and must result in a “fair and equitable local rate support structure,” aided by universal service rate support, for areas where the cost of providing local service exceeds the rates charged by providers.¹⁵ These are complex requirements and limitations, but they do not, in Sprint Nextel’s view, technically bar use of a “reverse auction” (notably, this is a term that is still undefined) to identify carriers acting as COLRs in high cost areas.

However, these requirements clearly do bar the Commission from conducting a “reverse auction” that is not open to all carriers on a “competitively neutral” basis.¹⁶ Any auction, for example, that did not permit the participation of wireless carriers as COLRs would not be competitively neutral. The Commission should not allow the CHCF-B Program to be the exclusive province of the ILECs.¹⁷ The Commission, therefore, should give immediate notice that it intends to reconsider both the *Universal Service Decision* and the *ULTS Decision*¹⁸ and

premature to address that question in these comments. However, Sprint Nextel does not concede that the Commission has such authority.

¹⁵ See PU Code § 739.3, subd. (c).

¹⁶ For example, the Commission cannot continue the *status quo*, in which it has defined “basic service” in such a way as to prevent wireless carriers from being eligible to act as COLRs and receive CHCF-B Fund support. See *Universal Service Decision*, *supra*, 1996 Cal. PUC LEXIS 1046, at *345-46.

¹⁷ Sprint Nextel is aware of only one non-ILEC COLR in California, Cox California Telcom, LLC (“Cox”). The fact that there is a non-ILEC COLR, however, does not alter the fact that the Commission has deliberately excluded wireless carriers from being eligible to participate in either the ULTS or CHCF-B Fund programs.

¹⁸ *Order Instituting Rulemaking on the Commission’s Own Motion to Consider Modifications to the Universal Lifeline Telephone Service Program and General Order 153*, R.98-09-005, Opinion [D.00-10-028] __ CPUC 2d __, 2000 Cal. PUC LEXIS 838 (“*ULTS Decision*”).

rule that neither the Moore Act¹⁹ nor P.U. Code §§ 270 and 276 bar the Commission from recognizing wireless carriers as eligible for inclusion in the Lifeline, and, by extension, the High Cost Fund, program.²⁰ The Commission could not credibly assert that a “reverse auction” was competitively neutral if the Commission failed or was unable to take the steps necessary for ensuring that wireless carriers and other intermodal carriers may participate in the auction.²¹

2. What processes and protocols should be established to implement a reverse auction for purposes of assigning COLR obligations and setting the level of subsidy support in high-cost areas served by the existing incumbents? Is a descending bid, simultaneous-close auction the best type of auction to determine support?

The unfortunate fact is that the Commission faces a difficult task in designing a reverse auction that is truly competitively-neutral. The Commission should not, in fact, underestimate the difficulty of the task ahead. At this point, Sprint Nextel only offers suggestions on the threshold matters it believes the Commission should address in designing and conducting a reverse auction. Here are just a few of the difficult issues ahead:

First, the Commission should identify “the service” that it wants carriers to provide if they “win” the reverse auction.²² Viewing the process as a request for quote (“RFQ”) process,

¹⁹ Stats. 1987, c. 163, § 2, the Moore Universal Telephone Service Act, *codified at* PU Code §§ 871-880, as amended (“the Moore Act”).

²⁰ Sprint Nextel extensively discussed the need for the Commission to reconsider the *Universal Service Decision* and the *ULTS Decision* in its “Reply Comments on Scoping Memo and Ruling of Assigned Commissioner and Administrative Law Judge Determining the Scope, Schedule and Need for Hearing” in R.06-05-028, *filed* September 14, 2007. *See id.* at 7-12, available at: <http://www.cpuc.ca.gov/EFILE/CM/72824.pdf>. As long as the Commission bars wireless carriers from being recognized as providers of “basic service,” it automatically bars wireless carriers from participating in the CHCF-B Fund program, which requires that COLRs drawing CHCF-B Fund monies must provide “basic service.”

²¹ Whether the Commission will be able to coordinate and manage R.06-05-028 and R.06-06-028 to ensure that the “reverse auction” is open to participation by wireless carriers and other intermodal service providers remains to be seen. *See* Sprint Nextel’s Response, *infra*, to Question 6 in Section 2.1 of the ACR, at 4, where Sprint Nextel addresses the question, “What service(s) should be included within the bid covered by the reverse auction?” *See also* Sprint Nextel’s Response, *infra*, to the questions in Section 3.3 of the ACR, at 7, where Sprint Nextel addresses the question, “Should existing rules for eligibility to receive B-Fund support be modified to accommodate a broader base of eligibility for B-Fund support to include wireless and other intermodal carriers?”

²² It goes without saying that failure to identify, in sufficiently precise detail, “the service” on which the Commission wished carriers to submit competing reverse auction bids, as if they were responding to a customer’s request for quote (“RFQ”), would constitute a defective process and would necessarily produce a defective result. In identifying “the service” on which carriers were to bid, the Commission would likely have to consider whether there were “service quality” standards it expected carriers to meet and, if so, what they would be. This is by no means an

the Commission might want to provide parties, in advance, with a copy of the agreement they would be required to sign in order to receive “high cost” support from the Commission. Without such a contract being specified in advance, the Commission might ultimately find, to its chagrin, that there was a wide discrepancy between the service the Commission thought it would get and the service the carrier actually offered to provide or actually provided.

Second, the Commission should identify the geographic area(s) for which it will solicit reverse auction bids. The Commission should consider whether bidders would be required to submit separate bids for each area, or whether they could submit a “package” bid for combined areas, and if so, what areas could be combined in a single “package.” In identifying the geographic areas for which bids would be requested, the Commission would want to consider whether it would make sense to hold an auction in any area that is not presently served by multiple carriers (wireline and/or wireless).²³

Third, the Commission should consider, and clearly advise all parties, whether wireless carriers (and other telecommunications service providers, regardless of technology employed) may participate in the reverse auction.

Fourth, the Commission should consider whether “the service” it requires one type of eligible carrier to provide (say, a wireless carrier) should be the same as “the service” that it requires another type of carrier to provide (say, a traditional wireline carrier or a VoIP-based service provider).²⁴

easy question to resolve. This question did not even arise in R.95-01-020 in 1995 and 1996, when the only providers of basic service were the ILECs, but it almost certainly would arise now, due to the different types of carriers that might now bid to be recognized as COLRs. This is but one example of the enormous amount of ground the Commission will have to cover before it can actually conduct a reverse auction.

²³ It is not clear, for example, that there will be a sufficient number of bidders to justify conducting an auction in some (or perhaps all) high cost areas. Whether there will be a sufficient number of participants remains to be seen, as the specification of “the service” on which carriers would bid could serve to dissuade carriers from participating in the auction. If the Commission imposes too many requirements, some carriers may elect not to participate.

²⁴ For example, the Commission could consider whether a wireless carrier could be required to meet one set of requirements for “basic wireless service” and whether a wireline carrier could be required to meet a different set of requirements for “basic wireline service” or, perhaps, “basic VoIP service.”

Fifth, assuming that the Commission permits wireless carriers and, possibly, other intermodal service providers to participate in the reverse auction, the Commission should consider whether there will be only one reverse auction “winner” (whether wireless or wireline or otherwise) or whether there will be one (or more than one) wireless and one (or more than one) wireline reverse auction “winner.”²⁵ At present, for example, the Commission has recognized that a given “high cost” area may have more than one COLR (*e.g.*, both Cox and AT&T are COLRs in areas in Southern California where both Cox and AT&T provide telephone service). The Commission should consider whether it will continue this approach or not. Designation of a single “winner” may foreclose competition, while, from a different perspective, designation of multiple winners, absent fund size constraints, may cause the total amount of subsidies to balloon. Balancing the competing equities in this dilemma will be very difficult.

Sixth, the Commission should consider whether to determine the reverse auction “winner” or “winners” on the basis of the support the carrier(s) requested or the retail price they state they would charge their customers, or both.

And seventh, the Commission should consider whether to receive simultaneous bids from multiple parties, with multiple rounds to determine a “winner” or “winners,” or whether other bidding techniques should be used.

These are but a few of the many difficult issues the Commission will have to address in designing a reverse auction. The Commission should recognize, therefore, the difficulty that carriers face in submitting comments on reverse auction issues without knowing, in advance, at least some idea of the Commission’s direction on these foundational issues.

²⁵ Sprint Nextel recognizes that question 9 on page 4 of the ACR asks parties to comment on whether “. . . only one COLR [should] be selected for each area, or . . . [whether] reduced subsidies should be available to qualifying competitive bidders.” As noted in the text in response to this question, *infra*, it is difficult to answer this question without information regarding the extent to which subsidies would be “reduced” to “qualifying” carriers.

3. The auction mechanism will require a bidding process predicated upon appropriate parameters of acceptable COLR service. What eligibility criteria for carriers and service quality standards should be established as a basis for reverse auction bidding? For example, what minimum standard of reliable 911 service would be necessary to qualify as a COLR as a result of a reverse auction bid? Should COLR status be granted for only a limited time subject to periodic renewal? If so, what should be the duration of COLR status?

Once again the Commission faces a difficult set of challenges to identify the eligibility criteria for participating in the reverse auction. However, in Sprint Nextel's view, any carrier that holds a certificate of public convenience and necessity ("CPCN") to provide local exchange service, regardless of technology used, or that has the requisite authority to provide wireless service in California, should be eligible to participate in the reverse auction.²⁶ The Commission should not impose any new service quality standards as reverse auction eligibility criteria beyond the standards that already apply to local exchange service providers and wireless carriers. By resisting parties' claims that there must be new and additional service quality standards, the Commission will ensure that its progress toward a reverse auction is not sidetracked into unproductive controversies.

In response to the ACR's question regarding "reliable 911 service," Sprint Nextel responds that the meaning of the term "minimum standard of reliable 911 service" is not clear, but in any event the Commission should not attempt to condition reverse auction participation on provision of 911 service in any manner new or different from that in which a carrier already provides 911 service. Again, the Commission should not allow the determination of reverse

²⁶ The ACR appears to recognize that it is imperative for the Commission to reconsider the definition of "basic service" adopted in the *Universal Service Decision* in 1996. See *id.* at 7 where the Assigned Commissioner asks parties to consider whether "existing rules for eligibility to receive [CHCF] B-Fund support be modified to accommodate a broader base of eligibility for B-Fund support to include wireless and other intermodal carriers. . . ." As indicated below, Sprint Nextel believes the Commission should reconsider the components of "basic service" so that wireless and other intermodal carriers are not excluded from providing basic service, drawing ULTS fund subsidies or drawing CHCF-B Fund subsidies. Such a modification is essential to promote competitive neutrality in the allocation of B-Fund support and is further essential to accomplish public policy goals of expanding universal service and expanding the reach of advanced services in California.

auction eligibility criteria to become the backdoor to new service quality standards issues that are being addressed in other Commission proceedings (*e.g.*, in R.05-04-005 and R.02-12-004).

The duration of the period in which a carrier should be recognized as a COLR would depend on whether the Commission is prepared to recognize more than one carrier as a COLR in a given area. If the Commission recognizes that there can be multiple carriers acting as COLRs in a given area, there would be a correspondingly smaller need for a sharp limit on the duration of recognition as a COLR. At the outset, the Commission should consider recognizing a carrier as a COLR for not more than two years, and after two two-year terms, the recognition/ designation period could perhaps be extended to five years.

4. Should threshold standards, such as financial fitness, be adopted to qualify to bid in the auction? Should there be a bond required?

The Commission should reserve the right to require bidders, on a confidential basis, to provide evidence to the Commission of their financial resources. The Commission should further reserve the right to disqualify from participation in the reverse auction any party that it does not believe will have adequate financial resources to provide “the service” required by the Commission.²⁷

The Commission should not allow any would-be auction participant, or affiliate of such participant, to challenge the financial qualifications of another party seeking to participate in the reverse auction. If auction participants were able to question the financial qualifications of other parties, larger parties could make it impossible for smaller parties to remain in the auction. Nothing good would come from such an approach.

The Commission should also disqualify from participation in the reverse auction any ILEC that is charging rates to its competitors for access services that exceed the economic cost

²⁷ The difficulty of identifying, in advance, the requisite level of financial fitness counsels against attempting to do so on a generic basis. The Commission should simply advise bidders that it reserves the right to examine their financial fitness and, subject to notice and opportunity to be heard, to disqualify parties with inadequate resources.

(long run incremental cost or “LRIC”) of providing such services. The ability to impose switched and special access charges above the economic cost of providing such services confers an unfair advantage on ILECs and skews both the bidding and auction results in their favor.

Finally, assuming that a bond against failure to provide the required service could even be obtained, which is unclear at best, adoption of a bond requirement would likely only serve (a) to keep many parties from participating in the reverse auction and (b) increase the cost of service to customers, since the bond would likely be very expensive to obtain. Sprint Nextel does not believe that adoption of a bond requirement will serve any useful purpose.

5. What sorts of regulatory compliance requirements should apply to a selected bidder? Should reliability standards be placed on COLRs? What Commission audit requirements may be warranted to verify and confirm that a winning bidder follows through with commitments to meet such specified minimum basic service quality standards? Should any penalties for withdrawal, such as the difference between the winning bid amount and the next carrier or reauction bid amount, be imposed?

Prior to the reverse auction, the Commission will have to identify exactly what it expects a winning bidder (or winning bidders) to do in providing service as a COLR. This specification will necessarily have to include the “minimum basic service quality standards,” if any, that the Commission expects a winning bidder to satisfy. In general, and as stated above, the Commission need not, and should not, adopt any new requirements for provision of “basic service.” As previously indicated, however, the Commission will have to revise the requirements of “basic service” adopted in the *Universal Service Decision* in order for wireless and other intermodal carriers to be able to participate in the reverse auction. The Commission should not add requirements after the bidding and/or selection of a winning bidder. Finally, it stands to reason that the Commission will want to assure itself that any party receiving CHCF-B funds is in fact providing the service that the Commission required a winning bidder to provide.

6. What service(s) should be included within the bid covered by the reverse auction? (Parties may incorporate, by reference, comments on CASF issues, to the extent deemed relevant.) What limitations or conditions should be placed on service(s) that may be included within (or excluded from) the bidding? Are there other elements that should be part of [a] bid [other] than the amount of universal service support for the specific area? Should bids to be placed on total support, support per subscriber, support per household, or some other basis?

Ultimately, the only subsidy the Commission ought to provide is to consumers who are eligible for support for basic service (but only basic service) under the ULTS program. Such support should only be available for consumers to purchase basic local exchange (also known as “plain old telephone”) service or the equivalent wireless service. The Commission should not subsidize the provision of broadband or advanced services. The Commission should not subsidize carriers, networks or services – the Commission should only provide financial support to consumers who, on a means-tested basis, can demonstrate that they clearly lack the financial wherewithal to purchase basic service without financial assistance.

As Sprint Nextel stated in its comments on the proposed California Advanced Services Fund (“CASF”), at best it is uncertain whether the Commission has the requisite authority to create a CASF or to use CHCF-B moneys to fund the CASF.²⁸ Moreover, it is unclear whether the Commission could operate a CASF on a competitively neutral and technologically neutral basis. If the goal of the high cost fund is affordable basic service or its wireless equivalent in high cost areas, then the support mechanism need not and should not support any other service beyond basic service.

²⁸ See Opening Comments of Sprint Nextel on Assigned Commissioner’s Ruling on Phase II Issues Related to the “California Advanced Services Fund,” filed September 26, 2007, available at: <http://www.cpuc.ca.gov/EFILE/CM/73289.pdf>; see also Reply Opening Comments of Sprint Nextel on Assigned Commissioner’s Ruling on Phase II Issues Related to the “California Advanced Services Fund,” filed October 3, 2007, available at: <http://www.cpuc.ca.gov/EFILE/CM/73494.pdf>. Sprint Nextel incorporates by reference herein its September 26 and October 3, 2007 Comments on CASF issues. In those Comments, Sprint Nextel questioned whether the Commission has jurisdiction to create an advanced services fund using monies collected through the CHCF-B program surcharge and suggested that the Commission should first seek legislative authorization before creating a CASF Fund program.

7. In what geographic area(s) should the initial auctions be held? How many separate auctions will be required? What is the appropriate transition time to phase-out existing COLR support and phase-in new COLR support? Should the same timeframe be used to phase-in coverage and other COLR obligations? Should build-out benchmarks be established?

Geographic areas should be determined on a competitively neutral basis, not based on incumbent LEC wire center or service boundaries. Bids should be submitted on a census block group (“CBG”) basis. The Commission plainly would not want to hold a separate auction for each CBG in California; by the same token, however, at the outset the Commission may want to conduct a small auction covering only a small number of CBGs on a “pilot” or “test” basis to gather information on the feasibility and conduct of a reverse auction.

A “build-out” benchmark should only be necessary where there is no basic service and no network facilities exist at all -- any new development should be open to market-driven service provision first. Rather than assume high cost fund support, if somebody builds a house or a developer plans a development and requests service, the Commission should first see if a carrier will provide service without receiving a “high cost” subsidy. If no carrier steps forward, then the right to act as a COLR for that area should be determined through a reverse auction. Only if no provider steps forward to provide service in a new development should the area be subject to support-bidding. In that situation, the build-out timeframe should be part of the bid.

8. Should one particular area be selected for a pilot project to test the operation of a reverse auction? If so, based upon what considerations?

The Commission should consider conducting some pilot reverse auctions. The process and results would likely be highly instructive. The Commission could perhaps use three different types of areas, *e.g.*, an area where the incumbent LEC is the sole provider of basic service, an area that is served by an ILEC and a cable-telephony provider, and an area that is served by the ILEC, a cable-telephony provider and multiple wireless providers. As indicated

above, the Commission will need to decide whether there will be a single “winner” of the reverse auction, or whether there will be a single wireline “winner” and a single wireless “winner,” or whether there will be multiple wireline and wireless winners in a given “high cost” area. One or more pilot programs may help the Commission decide how to identify the “winner” or “winners” of the reverse auction.

9. Should only one COLR be selected for each area, or should reduced subsidies be available to qualifying competitive carriers?

The Commission should always encourage competition and may consider allowing more than one supported provider. However, the Commission should only permit multiple carriers to act as COLRs if the total “high cost” support for a given area is limited to the existing “high cost” support for that area. Responding to this question is difficult because it is not clear what the ACR means in speaking of “reduced subsidies” for qualifying “competitive carriers.” Does “reduced” mean a non-incumbent competitor’s support should be lower in comparison to the subsidy provided to an incumbent? Or does “reduced” mean all winning providers in a given area would receive a lower subsidy? The former meaning would violate the required competitive neutrality standard.

10. Should the size of the service area subject to reverse auction bidding be set by the Commission or determined by the bidding process?

The size of the service area subject to reverse auction should be pre-determined and it should be both technology-neutral and competitively neutral. Allowing each bidder to define its own support area would likely result in chaos; the Commission would find it very difficult to compare competing bids if each party could define its own area and the areas for which bids were submitted were different. If the area subject to reverse bidding were determined on an

ILEC-centric bases, such as existing ILEC wire center boundaries, it would not be technology-neutral or competitively neutral.

11. What is a reasonable cost proxy to serve as an initial auction “reserve” or upper bound on bids that would be acceptable as the basis for payment of support levels? What is the most expeditious manner to derive an appropriate benchmark for setting such upper bounds? As a default, should any qualifying upper bid be at or below the existing B-Fund support level for designated areas subject to the auction? If the HM 5.3 Model is used to designate areas subject to the auction, should a cap be placed on the results? What is a reasonable cap?

The upper limit on support per line should be less than the existing support level for that line, which would be consistent with the reductions in the high cost fund effected by D.07-09-020. At the outset, the difference between the upper limit on support per line and the existing support level need not be large. Using the existing support level and discounting that support level by, say, 10 to 20 percent, would likely be the most expeditious means for determining a reasonable, upper bound. The Commission should facilitate parties’ analysis of this issue by making information publicly available regarding the existing support level for each CBG where the monthly per line cost of providing service is thought, on the basis of the outdated information on which the *Universal Service Decision* was based, to be above \$36. The Commission should make the following information publicly available: the identity and location of the CBG, the cost proxy model (“CPM”) estimate of the cost of providing service in that CBG, and the number of lines that are currently being subsidized in each CBG. This information, which would be extremely useful in constructing a reverse auction bid, should not be known only to the ILECs and the Commission, and to the extent the Commission fails or refuses to make this information available, then to that extent the reverse auction will not be competitively neutral.

However, there is no reason in a declining cost and increasingly competitive industry to increase subsidies. The Commission should automatically reject any claim by the ILECs, singly or collectively, that the per line cost of providing subsidized service in “high cost” CBGs has

increased since the 1996 *Universal Service Decision*, which was based on circa-1990 cost information. (Indeed, any claims that the per line cost in a given area has simply “remained the same” should be viewed with great skepticism.) Further, the Commission should automatically reject any claim by the ILECs, singly or collectively, that the total cost of a high cost fund program in California should exceed the \$119.2 million price tag determined in D.07-09-020.

Moreover, if the Commission elects to place a series of interim caps on the price of “basic service” after January 1, 2009 – something which Sprint Nextel does not believe the Commission should do and which Sprint Nextel strongly urges the Commission *not* to do – then the amount of support per line should automatically decrease in keeping with each increase in the cap on basic service prices.

12. What sorts of cost proxy determinations or updates may be necessary or desirable as a basis to identify areas subject to bidding under the reverse auction? Is there a better approach to forecast service needs of the area for the duration of the COLR designation?

If an appropriate upper bound on support is established, if implicit subsidies are removed from switched access rates, if support is made available only to cover the cost of stand-alone basic voice service, and if the auction is truly open to all competitors and technologies, then new cost proxy “determinations or updates” (for the purpose of identifying areas that would be subject to bidding under a reverse auction) should be unnecessary.²⁹ Sprint Nextel examines each of these important conditions in turn.

First, as proposed above, the Commission should begin from a strong presumption that, even in supposed “high cost” areas, but perhaps *especially* in such areas, the cost of providing service, which was estimated at a very high level to begin with (in the *Universal Service Decision* in 1996), has declined. In an industry that is markedly characterized by declining costs

²⁹ For the purpose of responding to the ACR’s questions, Sprint Nextel interprets the term “determinations or updates” to mean “*increases*” in existing support levels. Sprint Nextel does not anticipate that the ILECs would seek to “update” costs for areas where (as should be the case) costs have *decreased*.

across the board, it could not possibly be otherwise. Sprint Nextel therefore proposed above that the Commission adopt an “upper bound” on support per line of at least 10 to 20 percent below the existing support level. By itself, such a correction would alleviate, quite considerably, the need for any new cost studies or “determinations or updates” and could conceivably result in a further reduction of the total size of the CHCF-B Fund program.³⁰ Given the difficulty of the undertaking that the Commission envisions (namely, using a model (HM 5.3) prone to spawning complex controversies that was developed by companies (“old” AT&T and MCI) that no longer exist to estimate the cost of providing *wireline* service in alleged high cost areas), Sprint Nextel is persuaded that the Commission would do much better, and would avoid considerable difficulty, expense and delay, if it simply adopted a reasonable discount on the existing level of support per line.³¹ While the goal of the undertaking, namely, updating cost proxies that are more than a decade old, is undoubtedly important, Sprint Nextel is not persuaded that the goal can or will be achieved within a reasonable time frame or at a reasonable cost to the parties involved.

Second, if the Commission were to consider the extraordinary premium *above* cost (no matter how determined, but especially above economic cost) that the ILECs currently charge and receive from their competitors for the provision of access services, the Commission would realize that there is no legitimate basis or reason for increasing existing support payments that the ILECs receive from the CHCF-B Fund for providing service in alleged “high cost” areas.

³⁰ An across-the-board reduction of the cost proxy model (CPM”)-generated costs by 10 to 20% could result in some CBGs moving beneath the \$36 benchmark adopted in D.07-09-020. Such a reduction would seem to be a better “. . . approach to forecast service needs of the area for the duration of the COLR designation” than trying to use HM 5.3 for a purpose for which it was not designed.

³¹ HM 5.3 is only a wireline model. Ideally, for “high cost estimating purposes,” the model would be able to estimate the costs of providing service using other technologies, and high cost subsidies would then be based on the least cost technology. At this time, however, it is not reasonably possible to update the model in this manner, due to the complete absence of public data on the costs of those other technologies, and because of the enormous amount of time, money and effort that would be needed to develop HM for that purpose. The “updating” that the Commission intends to perform will merely yield an estimate of providing service using wireline technology, and will provide the Commission with little, if any, of the information that a proper “updating” of the model would provide.

The ILECs' position as providers, on a monopoly basis, of access services already guarantees them sufficient revenues to provide service in alleged "high cost" areas. In a well ordered world, the ILECs' continued extraction of monopoly rents from their provision of access services would disqualify them from receipt of CHCF-B Fund support.

Third, there is only one means by which the Commission may properly take account of the revenues that the ILECs receive from providing "other services" – *i.e.*, services other than basic local exchange service – and that is to rule that "high cost" support is not available for any line where the ILECs are providing other services. Among other things, the existence of the carrier-customer relationship is such that carriers have the opportunity to derive additional revenues from provision of vertical services, long distance services, international calling services, enhanced services (such as voicemail), broadband services and other information services. Viewed in this light, the carrier-customer relationship is so valuable that it is farfetched to believe that ILECs would abuse this relationship by raising prices above reasonable loss-leader levels. In short, there is no need for a subsidy for lines on which customers purchase additional services because the revenues and profits derived from these services are such as to obviate the need for any subsidy.

Fourth, if the Commission were to ensure that the reverse auction is open to all competitors and technologies, then the Commission would not need to make any "update" at all of cost figures in alleged "high cost" areas. The Commission would likely see that the total cost of providing a subsidy for "basic service" or its equivalent in alleged "high cost" areas would be considerably less than the \$119.2 million price tag in D.07-07-020.

For these reasons, Sprint Nextel does not believe there is a need for new "determinations or updates" for existing cost proxies for alleged "high cost" areas.

13. If an existing ILEC COLR does not submit a selected bid during the auction, should there be any additional requirements that the ILEC make its existing facilities in the designated area available to a new COLR?

Yes.

For the same reasons as were stated above regarding the value of the carrier-customer relationship, the Commission should be confident that no existing ILEC COLR will fail to submit a bid. Whether its bid will be selected is another matter. If its bid were not selected in the reverse auction, however, the ILEC should certainly be required to make its existing facilities available to a new COLR.

Sprint Nextel recognizes, of course, that there could be differences of opinion between carriers as to the *additional* rates, terms and conditions, *beyond those* already required and applicable to unbundled network elements (“UNEs”), under which existing ILEC facilities should be made available to a new COLR. If the ILEC were aware, however, that it might be required to make its facilities available to a winning bidder at rates, terms and conditions specified by the Commission, *e.g.*, at TELRIC-based rates, it might be that much more intent on winning the reverse auction itself. In any event, the ILEC could scarcely complain if the Commission derived rates, terms and conditions for facilities to be made available to COLRs, where needed, that were derived, in part, from an ILEC’s own bid.

Finally, the Commission should require ILECs to declare, prior to the Commission’s conducting any reverse auction(s), whether there are any areas where they intend not to bid and instead intend to relinquish their COLR status. The Commission should also require ILECs to identify the amount by which they will increase their retail rates in order to make it economic for them to continue to provide service in the area(s) where they will no longer serve as COLRs. This requirement would give other bidders information they need to determine the support amount and the appropriate corresponding bid. Realistically, however, as stated above, Sprint

Nextel does not believe that there would be any areas where the ILECs would no longer seek to serve as COLRs.

II. COST PROXY MODEL UPDATE INFORMATION

In the comments that follow, Sprint Nextel addresses the questions identified in Section 2.2 of the ACR. At the outset, Sprint Nextel acknowledges that, if the CHCF-B program is to continue, it is important for the Commission to identify which areas are properly considered as high cost areas. Nonetheless, Sprint Nextel is skeptical how easily and quickly such information can be developed using the HM 5.3 Model on a “stopgap” basis. The ILECs are likely to complain that the costs produced by the HM 5.3 Model are not representative of the costs they actually confront in providing service in rural areas in California. The onslaught of controversies and disputes that attended use of the HM 5.3 Model in determining the TELRIC costs of AT&T’s and Verizon’s UNEs in D.04-09-063³² and D.06-03-025,³³ respectively, does not augur well for the Commission being able to “update” Cost Proxy Model-based costs within a brief time period. As stated above, the Commission would do well to allow the CHCF-B program to terminate as of January 1, 2009, in order to avoid the substantial diversion of resources that will be required to update costs for the CHCF-B program. None of the comments below should be understood as an endorsement by Sprint Nextel of the cost “updating” effort.

³² *Joint Application of AT&T Communications of California, Inc. (U 5002 C) and WorldCom, Inc. for the Commission to Reexamine the Recurring Costs and Prices of Unbundled Switching in its First Annual Review of Unbundled Network Element Costs Pursuant to Ordering Paragraph 11 of D.99-11-050*, A.01-02-024, and related proceedings, Opinion Establishing Revised Unbundled Network Element Rates for Pacific Bell Telephone Company DBA SBC California [D.04-09-063] (2004) __ CPUC 2d __, 2004 Cal. PUC LEXIS 476.

³³ *Rulemaking on the Commission’s Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks*, R.93-04-003; *Investigation on the Commission’s Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks*, I.93-04-002, Opinion Establishing Unbundled Network Element Rates and Price Floors for Verizon California and Modifying Decision 99-11-050 Regarding Monopoly Building Blocks [D.06-03-025] (2006) __ CPUC 2d __, 2006 Cal. PUC 107, *modified*, Decision Granting, in Part, the Petitions of Verizon California Inc. (Verizon) and Verizon/Covad Communications Company to Modify D.06-03-025 [D.07-10-033] (2007) __ CPUC 2d __, 2007 Cal. PUC LEXIS __.

1. In order to mitigate the risks that the HM 5.3 Model may produce anomalous results, how, or in what manner, should the total investment calculation produced by the HM 5.3 Model be capped to avoid excessive subsidies?

In determining support, the Commission must consider all sources of revenue and profit available over the ILEC's investment (basic local service, vertical services, long distance services, enhanced service, broadband service, and video, internet and other information services) and reduce available support by that amount OR it must allocate investment and expense to those non-basic services OR it must limit support to those customers that only take stand-alone voice. Any other result simply subsidizes services other than basic voice – with dramatically anti-competitive consequences. The cost allocation task is probably the most difficult undertaking for the Commission, since the majority of the costs involved in providing such services do not change whether one service or many services are provided over the same line; hence, subtracting an “averaged expected non-basic revenue” from the support amount or limiting support to customers that only take stand-alone basic service would be administratively easier and most appropriate. In any event, the total investment calculation produced by the HM 5.3 Model should not lead to an increase in the total \$119.2 million price tag envisioned in D.07-09-020.

2. Why should any other adjustments be considered?

The Commission should consider eliminating from the cost proxy modeling process any areas that are already served by more than one intermodal provider. The number of intermodal providers would be an indication of the extent to which customers have competitive alternatives to choose from. This would narrow the number of areas for which cost modeling would have to be completed. Alternatively, as explained above, the Commission could automatically adjust the existing CPM-generated cost for each CBG by a 10 or 20 percent reduction, and all CBGs with adjusted costs less than the benchmark of \$36 would be ineligible for cost support. Finally, as

stated above, no matter what costs the HM 5.3 Model produces, the Commission should make it clear that the total amount of support payments will not exceed the \$119.2 million cost figure identified in D.07-09-020 (which is likely too high to begin with).

3. What other possible adjustments to the cost proxy should be considered in order to avoid excessive subsidies (e.g., limiting support only to the operations and maintenance costs for existing lines as derived from the model)?

Any additional steps the Commission can take to pare the subsidy payments the ILECs are still receiving for providing service in alleged “high cost” areas would be appropriate, long overdue, and pro-competitive.

For example, the Commission should make it clear that the total cost of the “high cost” program will not exceed \$119.2 million under any circumstances. In addition, the Commission should ensure that both the CD and DRA have the experts and resources they need to operate the HM 5.3 Model to ensure that use of this model does not result in unjustified costs being built into a “high cost” program.

Finally, however, as previously explained, the best step the Commission could take would be to eliminate this program in its entirety, as there no longer is a need for a “high cost” support program in California. If the ILECs try to raise their prices for “basic service” to unreasonable levels, they will lose customers; the ILECs understand the likelihood of this result, and because of the value of the existing carrier-customer relationship, they will not take the risk of losing their existing customers. The Commission can and should be willing to trust the results of the marketplace, as it did in D.06-08-030. If the Commission fails to do so, it will be an indication that the Commission did not really believe what it said in D.06-08-030 concerning the existence of effective competition throughout California.

4. What other adjustments to the HM 5.3 model may be appropriate to streamline the updating process while ensuring that the resulting cost proxies are reasonable for deriving B-Fund support levels as an interim transition to the reverse auction?

By ensuring that both DRA and CD have access to experts on the HM 5.3 Model, the Commission will receive the necessary information on appropriate adjustments to the model for streamlining any updating process.

5. What procedural measures may be necessary in order to facilitate the timely production of cost model runs, provision for discovery, protection of proprietary data, and other measures to develop an adequate record on cost model updates?

Sprint Nextel does not see any need for new, different or special procedures to accomplish these purposes, as these are all measures that the Commission is familiar with from many past proceedings.

III. TRANSITIONAL BASIC RATE CAPS

Sprint Nextel responds below to the questions set forth in Section 3.1 of the ACR.

(a) To promote an orderly transition and prevent sudden large rate increases, what maximum level above the currently authorized caps should be set as the revised cap on basic rates for each respective ILEC before full pricing flexibility is to take effect?

The Commission should eliminate any price caps as of January 1, 2009. If the Commission, however, mistakenly retains price caps on basic service beyond that date, it should expedite price cap increases or eliminate price caps as quickly as possible after that date. Further, it should require any increases in the price cap to be offset immediately by reductions in intrastate access rates, either switched or special, (first) and then CHCF-B Fund support (a very close second). Both sources of undue subsidy should be taken away from the ILECs as quickly as possible.

In short, there should be an immediate and complete lifting of the caps on the ILECs' basic service rates. For the reasons set forth in the attached declaration of Chris Frentrup, the

Commission need not fear sudden and extraordinary increases in ILEC retail rates. In response to elimination of the CHCF-B subsidy, ILECs should be able to raise their basic service rates to whatever level they believe the market will allow. Although it might seem harsh, a flash cut to market rates for basic service is appropriate because competition will fully moderate and prevent any precipitous increases. Competition will constrain anomalously large increases, including increases imposed on a geographically deaveraged basis.³⁴ The economic efficiencies that result from proper price signals (*i.e.*, the elimination of artificially low prices for basic service in the retail marketplace) will more than offset, in consumer benefits, any inconvenience that consumers may incur as they switch to carriers and services that make the most economic sense for them.

(b) What period of time is appropriate for the phase-in of increases in the caps on ILEC basic rates to transition from current levels to a level at which further cap restrictions can be eliminated and full pricing flexibility implemented?

As stated above, no period of time is necessary – the cap on basic service prices can and should be lifted immediately. As previously stated, there should not be any cause for concern or apprehension at the Commission, because the competitive retail marketplace will effectively constrain any basic service price increase abuses that might be attempted by the ILECs.³⁵

This is the most important step before the Commission if it wishes to see California complete the transition to fully competitive markets envisioned in D.06-08-030.³⁶

³⁴ The Commission might want to remind ILECs that, if it saw any evidence of unchecked abuses of pricing freedoms, it would retain the power to impose stricter controls on ILEC prices, including a return to rate-of-return ratemaking where justified by the nature of the abuses observed. Sprint Nextel believes that market pressures will combine with social and political pressures to dissuade the ILECs from the conduct that TURN, for example, fears. In any event, through use of means-based subsidies such as those provided by the ULTS program, the Commission can be assured that customers that truly need protection from high prices will have access to such support.

³⁵ In support of this conclusion, *see* Exhibit 1 (attached), Declaration of Chris Frentrup. Dr. Frentrup explains why competitive pressures are likely to constrain ILEC attempts to impose increases in basic service prices and, in addition, dissuade ILECs from attempting to engage in geographic price deaveraging for basic service in California.

³⁶ The Commission, however, should also focus on the benefits that will flow to all Californians if, in addition to removing *retail* price controls (by allowing price caps on basic service to expire as of January 1, 2009), it directs its attention to correcting problems at the *wholesale* level. Regrettably, California ILECs are still able to charge

IV. CERTIFICATION PROCESS TO QUALIFY FOR B-FUND SUPPORT

Sprint Nextel here responds to the following question in Section 3.2 of the ACR:

What process should be implemented whereby the COLR shall certify that its services and rates in high cost areas are reasonably comparable to services offered in urban areas once full pricing flexibility takes effect?

Given the comments that Sprint Nextel has provided above, it should not come as a surprise that Sprint Nextel does not believe that any new process is necessary for a COLR to certify that its services and rates in high cost areas are reasonably comparable to services offered in urban areas once full flexibility takes effect. The normal operation of the competitive markets that the Commission itself found to exist throughout California in D.06-08-030 will automatically suffice to ensure that an ILEC's, or any other carrier's, services and rates in alleged "high cost" areas are *reasonably comparable* (not "the same," as some parties would have them, but "reasonably comparable") to its services and rates in urban areas.

V. BROADENING THE BASE FOR ELIGIBILITY TO RECEIVE B-FUND SUPPORT.

Sprint Nextel here responds to the questions in Section 3.3 of the ACR as to whether there should be a broader base of eligibility for B-Fund support to include wireless and intermodal carriers.

Should existing rules for eligibility to receive B-Fund support be modified to accommodate a broader base of eligibility for B-Fund support to include wireless and other intermodal carriers?

Yes.

switched and special access prices that are many times higher than the economic cost of providing such services. Once the Commission has eliminated price caps on basic service in California, it will be in position to begin paring away the undue monopoly rents (subsidies) that the ILECs exact from their competitors through exorbitant switched and special access prices. The Commission should set its sights on this goal, because once this goal is achieved, *consumers* will enjoy the full panoply of benefits (such as lower prices and better service) that competition brings.

As Sprint Nextel explained above, if the CHCF-B program continues beyond January 1, 2009, enlarging the number of carriers eligible for B-Fund support is legally required by Public Utilities Code Section 739.3, pursuant to which the Commission must ensure that any program for assisting carriers is “competitively neutral” and “broadbased.” If the Commission continues to exclude wireless carriers from being eligible for the CHCF-B program, it will fail to meet the requirements of this statute.

This is one of the most important changes to be made in the CHCF-B Fund program if it continues. Including wireless carriers within the base of carriers eligible for CHCF-B Fund support will enhance the competitiveness of the market and redound to consumers’ benefit by increasing their service options and ensuring that rates are reasonable. If, on the other hand, the Commission were somehow to fail to make this change, it would essentially ensure that most consumers in California continue to have only one COLR’s service available. Again, this would completely frustrate the competitive vision embraced by the Commission in D.06-08-030.

What other considerations or revisions in existing rules may be appropriate or necessary to accommodate such a change?

As Sprint Nextel has previously recommended,³⁷ the Commission should immediately provide notice that it intends to reconsider the *Universal Service Decision* and the *ULTS Decision* and to rule that the Commission is not barred from recognizing wireless service as eligible for inclusion in the CHCF-B Fund and the ULTS Fund Lifeline programs. If the Commission were to fail to satisfy the notice-and-opportunity-to-be-heard requirements of Public Utilities Code Section 1708, it will inevitably encounter legal challenges to any revisions in the definition of “basic service” and in the CHCF-B and ULTS programs. This would unnecessarily imperil critical reforms.

³⁷ See “Reply Comments of Sprint Nextel on Scoping Memo and Ruling of Assigned Commissioner and Administrative Law Judge Determining the Scope, Schedule and Need for Hearing in this Proceeding,” at 7-12, filed September 14, 2007, in R.06-05-028 and available at: <http://www.cpuc.ca.gov/EFILE/CM/72824.pdf>.

Having satisfied any procedural requirements, the Commission should then immediately move to modify the requirements of “basic service” adopted in D.96-10-066.³⁸ In the list that follows, Sprint Nextel has utilized ~~overstrike type face~~ to indicate the requirements adopted in D.96-10-066 that should be eliminated and underscored text to indicate any new, clarifying text:

“B. Basic service includes the following service elements:

- “1. access to ~~single party local exchange service~~ dial tone;
- “2. access to all interexchange carriers offering service to customers in a local exchange, unless the carrier providing service is a wireless or VoIP-based carrier.
- “3. ability to place calls;
- “4. ability to receive free unlimited incoming calls, unless the carrier providing service is a wireless or VoIP-based carrier;
- “5. free touch tone dialing;
- “6. free and unlimited access to 911/E911;
- “7. access to local directory assistance, and access to foreign NPAs;
- “8. Lifeline rates and charges for eligible customers;
- “9. customer choice of flat or measured rate service, unless the carrier providing service is a wireless or VoIP-based carrier;
- “10. free provision of one directory listing per year as provided for in D.96-02-072, unless the carrier providing service is a wireless or VoIP-based carrier;
- “11. free white pages telephone directory, unless the carrier providing service is a wireless or VoIP-based carrier;
- “12. access to operator services;
- “13. voice grade connection to public switched telephone network;
- “14. ~~free~~ access to 800 or 800-like toll free services;

³⁸ See *Universal Service Decision*, *supra*, Appendix B.

“15. one-time free blocking for 976 and 900 information services and one time billing adjustments for charges incurred inadvertently, mistakenly, or that were unauthorized;

“16. access to telephone relay service as provided for in *PU Code* § 2881;

“17. free access to customer service for information about ULTS, service activation, service termination, service repair and bill inquiries.”³⁹

These modifications are necessary to 1) conform the elements or components of basic service to technical differences in the way that wireless and VoIP-based services are provisioned, 2) to reflect the fact that wireless carriers do not collect access charges from IXC's for the origination or termination of long distance calls, and 3) to reflect the fact that, due to current public policy concerns, wireless numbers do not appear in directories. These modifications would make the definition of basic service technology-neutral and competitively neutral and would not result in wireline carriers being excluded from the CHCF-B or ULTS programs.⁴⁰

VI. STANDARDS/PROCEDURES FOR FUTURE PERIOD REVIEW OF THE B-FUND PROGRAM.

Sprint Nextel responds to the following question in Section 3.4 of the ACR:

What standards and procedures should be applied for future periodic review of the B-Fund program in order to ensure that the program continues to be effective in meeting the Commission's universal service goals?

³⁹ The indicated changes to Part B of Appendix B of the *Universal Service Decision* are meant to be illustrative, and do not constitute an exhaustive list of all the modifications and amendments of the *Universal Service Decision* and the *ULTS Decision* that may be required for wireless carriers and other intermodal carriers to be eligible for participating in the CHCF-B Fund and ULTS Fund programs on a competitively neutral basis.

⁴⁰ For example, not all wireless service offerings allow wireless customers to receive unlimited incoming calls at no extra charge (although such offerings may be purchased for a nominal additional amount). But no wireline service offerings permit wireline customers to make a call from anywhere within the serving territory. Imposing a requirement that a wireless basic service offering must permit unlimited incoming calls is no more fair than requiring that wireline carriers must allow their customers to make a call from anywhere within their service areas. Such requirements are not technology neutral or competitively neutral.

The Commission should eliminate the CHCF-B on the same date that full price flexibility is granted – on the assumption that the future life of the CHCF-B Fund will be very short, there should not be any need for periodic review.

Conclusion

Sprint Nextel greatly appreciates the Assigned Commissioner's having provided carriers with the opportunity to comment on the important topics set forth in the ACR. Summarizing the comments above, Sprint Nextel recommends that the Commission adopt the following conclusions:

- The CHCF-B program is no longer necessary.
- Continuation of the CHCF-B program as it is presently constituted would be anticompetitive and harmful to both carriers and, especially, consumers.
- The CHCF-B Program should be allowed to expire as of January 1, 2009.
- Therefore, the Commission does not need to update the existing, long-out-of-date cost proxies it developed in 1996 for identifying supposed high cost areas in California.
- Likewise, the Commission need not devote resources for attempting such an update through use of the HM 5.3 Model.
- In addition, the Commission need not conduct a reverse auction to identify COLRs to provide service in the supposed high cost areas.
- Competition at the retail level is sufficiently vigorous that the Commission no longer needs to impose rate caps on basic service.
- Continued imposition of price caps on basic service will result in inefficient outcomes that are harmful to consumers and to California's economy as a whole.
- Thus, the Commission should remove all price caps on basic service as of January 1, 2009.

- The Commission should immediately modify eligibility restrictions for both the ULTS and, to the extent it continues, the CHCF-B programs so that wireless and other intermodal carriers are eligible to participate in and receive subsidy funds under these programs on a competitively neutral basis.
- The Commission should ensure that both the ULTS program and, to the extent it continues, the CHCF-B Fund program are conducted and operated on a competitively neutral basis, without any continuing bias in favor of the ILECs.
- The Commission should not underestimate the difficulties it faces in attempting to conduct a reverse auction to determine the winner of support in alleged high cost areas; there are many complex issues on which the Commission must provide the parties with guidance before they can assist the Commission in designing a reverse auction.
- The Commission should be cautious regarding the extent to which the HM 5.3 Model can reliably be used for determining the cost of basic service in high cost areas.
- The Commission should ensure that both DRA and the CD have access to HM 5.3 Model experts for proper assessments of the ILECs' attempted use of that model in this proceeding.
- The Commission should clearly state, prior to conducting a reverse auction or attempting to use the HM 5.3 Model to determine new cost proxies for high cost areas in California, that the annual total cost of the CHCF-B program, for all participating carriers, will not exceed \$119.2 million under any circumstances.

[signature page follows]

Respectfully submitted:

SPRINT NEXTEL

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Attorneys for Sprint Nextel

Dated: November 9, 2007

Certificate of Service

I, Earl Nicholas Selby, hereby certify that, on November 9, 2007, I caused a copy of the foregoing document, entitled:

**COMMENTS OF SPRINT NEXTEL
ON ASSIGNED COMMISSIONER'S RULING
REGARDING THE SCOPING AND SCHEDULING OF PHASE II ISSUES**

**(including Exhibit 1 thereto, which is attached and entitled:
DECLARATION OF CHRIS FRENTROP)**

to be served on the parties to this proceeding by electronic mail to the electronic mail addresses on the service list maintained on the Commission's Web site for this proceeding, as indicated on the following page.

I also certify that, on November 9, 2007, I caused a copy of the foregoing document to be served on the following persons at the California Public Utilities Commission, 505 Van Ness Avenue, San Francisco, CA 94102, by United States Mail, first class postage prepaid: Commissioner Rachelle B. Chong, Advisor Robert Haga, and Administrative Law Judge Thomas R. Pulsifer. I further certify that, on October 3, 2007, I caused a copy of the foregoing document to be served on: La Tanya Linzie, Cox California Telcom, LLC, 2200 Powell Street, Suite 1035, Emeryville, CA 94608, by United States Mail, first class postage prepaid.

I certify that the above statements are true and correct.

Dated: November 9, 2007 at Palo Alto, CA.

_____/s/
Earl Nicholas Selby

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EXHIBIT 1

DECLARATION OF

CHRIS FRENTROP

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking into the)	
Review of the California High Cost)	R.06-06-028
Fund B Program)	
_____)	

DECLARATION OF CHRIS FRENTROP

Introduction

1. The Assigned Commissioner's Ruling in this proceeding, filed October 6, 2007, posed several questions regarding proposed reforms of the California High Cost Fund-B ("CHCF-B") Program. Specifically, the Commission asked in Section 3.1 of that ruling:

- a) what maximum level above the currently authorized caps should be set as the revised cap on basic rates for each respective ILEC before full pricing flexibility is to take effect, and:
- b) what period of time is appropriate for the phase-in of increases in the caps on ILEC basic rates to transition from current levels to a level at which further cap restrictions can be eliminated and full pricing flexibility implemented.

2. The purpose of this declaration is to respond to these issues, which deal with the need for a continuing cap on local rates. I will describe why a continuing cap is unnecessary due to the constraining effect on retail prices of the local service competition that the Commission relied on in D.06.08.030. I will begin with a review of the types and strengths of competition for local service in the areas served by the companies under the CHCF-B program, with special emphasis on the ability of this competition to restrain these companies' pricing. I will then examine whether the incumbent local exchange companies ("ILECs") will be able, or even likely to try, to raise their rates more in their rural, high cost areas. Finally, I will discuss why geographic deaveraging of rates, so long as that deaveraging is cost-based, should not necessarily be viewed as undesirable.

3. My name is Chris Frentrup. I am a Director and Senior Economist for Sprint Nextel, Inc., located at 2001 Edmund Halley Drive, Reston, Virginia 20191-3436. I joined Sprint Nextel in February of 2006 as a Director – Senior Economist. As part of the duties of that position, I help develop Sprint Nextel’s universal service policy, and prepare testimony and contribute to pleadings that advocate that policy at both the federal and state levels.

4. Prior to joining Sprint I worked for two years at MiCRA, Inc. where I primarily worked on telecommunications items, including estimating the costs of providing unbundled network elements and the costs of international cables. Before MiCRA, I worked for nearly ten years at MCI as a senior economist developing MCI public policy for several proceedings before the Federal Communications Commission (FCC), including price cap regulation, universal service reform, access reform, Bell Company entry into long distance, and pricing of unbundled network elements. Prior to that, I worked at the FCC for nearly seven years as an Industry Economist, reviewing access tariffs under the rate of return rules and serving on the task force that developed the FCC’s price cap rules for AT&T and the local exchange companies. Prior to joining the FCC, I worked for two years at AT&T forecasting revenue and demand.

5. I have testified before the Kansas and Wisconsin public utility commissions on universal service and have supported the development of testimony in many other states. I have also prepared and assisted in the preparation of numerous pleadings at the Federal Communications Commission. I received a Bachelor of Arts degree from the University of Texas in 1976 and a Doctor of Philosophy in Economics from Texas A&M University in 1984. A copy of my curriculum vitae is attached to this declaration.

Competition will Constrain Retail Prices if the Cap is Lifted

6. The Commission’s recent decision in its consideration of the Uniform Regulatory Framework (URF) was based on the premise that there is sufficient competition in the market for

the provision of local telephone service in California to ensure that rates are just and reasonable. The Commission found in D.06-08-030 that the ILECs in question - AT&T, Verizon, SureWest and Citizens - face competition from wireless carriers, cable companies, Voice over Internet Protocol (VOIP) carriers such as Vonage, and competitive local exchange carriers (CLECs) using unbundled network elements and their own network facilities.

7. Multiple wireless carriers provide service in most of California. Sprint Nextel provides coverage throughout most of California.¹ AT&T Wireless provides service using its own network in large portions of central and southern California and through arrangements with unaffiliated partners in significant portions of northern California.² Verizon Wireless covers the vast majority of California territory with its wireless network.³ T-Mobile also provides wireless service in portions of California.⁴ Combined, these big four wireless carriers and several other smaller regional carriers provide wireless service to almost all of California.

8. Cable companies are providing cable telephony to increasing numbers of subscribers. Nationwide, cable operators provided telephone service to 12.1 million customers as of June 2007.⁵ This total is up from 7.5 million the year before.⁶ Although these statistics are not specific to California, they do suggest that cable telephony is a growing competitive alternative to the ILECs' local telephone service.

9. VOIP providers use customers' pre-existing broadband connections to provide service. Although I have been unable to locate data on the number of customers in California served by these companies, a recently released Federal Communications Commission (FCC)

¹ Sprint Nextel's coverage map can be accessed at http://www.sprint.com/index_c.html, where one can enter a Zip code to obtain a searchable map showing Sprint Nextel's network coverage.

² AT&T has a national map of its network coverage on its website at <http://www.wireless.att.com/coverageviewer/>.

³ Verizon Wireless' coverage map can be found by entering a city and state combination or a Zip code on its website at <http://www.verizonwireless.com/b2c/CoverageLocatorController?requesttype=NEWREQUEST>.

⁴ T-Mobile's coverage map can be viewed at <http://www.t-mobile.com/coverage/>.

⁵ See the National Cable & Telecommunications Association's website at <http://www.ncta.com/ContentView.aspx?contentId=57>.

⁶ See <http://www.ncta.com/ContentView.aspx?contentId=61>.

report reveals that the necessary broadband connections are widely available and being purchased by customers. Specifically, the Report shows that in California as of December 31, 2006, 83 percent of residential telephone customer premises were equipped to provide DSL service and 98 percent of residential premises with cable service were capable of providing cable modem service.⁷ As a result of this nearly ubiquitously available broadband, over 7.7 million residential customers in California had purchased broadband service.⁸ Clearly, VOIP providers could compete to provide local telephone service to each of these broadband customers.

10. The market presence of wireless, cable and other CLEC competitors can be seen in the data that are reported in the FCC's Local Telephone Competition report on the number of lines served by the various types of carrier.⁹ Table 13 of that report indicates that there are 16 ILECs in California and 54 CLECs.¹⁰ That report also shows that ILECs serve 19.5 million switched access lines in California,¹¹ while all CLECs, including cable companies, serve 2.9 million lines¹² and wireless carriers have 27.5 million subscribers.¹³ These data are consistent with the Commission's finding that the four ILECs that participate in the CHCF-B program face retail competition from these carriers.¹⁴

11. The mere presence of competitors does not guarantee that they will constrain the incumbents' pricing. However, one of the ILECs that participates in the CHCF-B program believes that in this case the competitors will. In its 2006 Annual Report, Citizens stated:

⁷ See Table 14 of High-Speed Services for Internet Access: Status as of December 31, 2006, released October 2007 and available online at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-277784A1.pdf.

⁸ *Id.* at Table 13.

⁹ The most recent version of this report, released January of 2007 and reporting data as of June 2006, is available online at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-270133A1.pdf.

¹⁰ The CLECs reported in that table do not include wireless carriers or "over-the-top" VOIP providers such as Vonage, but do include cable companies.

¹¹ See Table 10.

¹² See Table 9.

¹³ See Table 14.

¹⁴ Even if retail competition is sufficiently strong to ensure that retail prices remain just and reasonable, the wholesale services that competitors must buy from the ILEC, such as access and interconnection, will remain uncompetitive. Thus, while Commission can lift retail price constraints, it must continue to constrain interconnection and access prices.

“the greater brand name recognition of some competitors may require us to price our services at lower levels in order to retain or obtain customers.”¹⁵

Clearly at least this ILEC feels some competitive pressure to reduce its retail prices.

12. The ability of a carrier to raise its price depends on the price elasticity of demand that it faces for its product. Price elasticity of demand is defined as the percentage change in quantity demanded for a given percentage change in price. The greater the change in quantity demanded for a given change in price, i.e., the more elastic demand is, the less likely it is that a carrier can raise its price in the market.

13. The elasticity of demand will depend on a number of factors, including among other items the number of alternative providers available, the substitutability of the products offered by competing carriers, and the value that customers place on additional services offered by competitors. All of these factors will constrain the ability of the ILECs in California to raise their retail prices to consumers once price controls are lifted in 2009.

14. In a perfectly competitive market, there are a large number of firms in the market so that each firm faces an infinite elasticity of demand, which means that it cannot change its price without all its customers switching to another provider. In a monopoly market, on the other hand, the monopoly firm need not worry about losing business to a competitor, and thus faces a much lower elasticity of demand. In general, the more providers there are in a market, the greater is the elasticity of demand faced by any individual provider. As already discussed above, there are numerous alternatives to the ILEC for providing local telephone service. The presence of these additional competitors will increase the elasticity of demand faced by the ILEC and limit its ability to raise its retail price to consumers. Thus, the proliferation of alternative providers, especially intermodal competitors who are providing service over their own facilities, constrain the ILECs' ability to raise their retail prices.

¹⁵ See Citizens Annual Report 2006, page 11, available online at <http://www.citizenscommunications.com/documents/Citizens2006-AR-10K.pdf>.

15. The similarity of the services offered by competitors will determine their substitutability. If all companies in a market are offering the same product, then customers will find it very easy to compare offerings among companies, and each company will face a higher elasticity of demand. Conversely, if companies are offering products with slightly different characteristics, then customers will have to weigh the differences in the characteristics before making their purchasing decision. In this case, each company's elasticity of demand will be slightly lower than if they were all offering the same service,

16. The ILECs' competitors, whether wireless, cable, or VOIP providers, typically do not offer the same stand-alone local service that is offered by the ILEC. Rather, they offer a bundled service which also includes long distance, features such as Call Waiting and Caller ID, and in the case of wireless, mobility. Indeed, it is partly in response to these packages that wireline ILECs have had to begin to offer similar bundles that include all-distance calling and a number of features. Because these bundles are direct substitutes for each other, the presence of several alternative providers increases the elasticity of demand faced by any individual carrier, and thus constrains the prices that the ILECs can charge for their bundles.

17. The fact that the competitors typically offer bundles rather than stand-alone local service does not mean, however, that the ILECs will not face competitive constraints when setting the prices for their stand-alone local service. The existence of the competitive bundle offerings can be expected to constrain the prices of stand alone local service as well. This is the case because customers will choose not only between companies but also between stand alone service or bundles. The premium that bundles can command will be determined by how customers value those bundles as compared to the stand alone service. If one set of competitors, e.g., cable or wireless is providing only bundles, then that competition will limit the price that the ILECs can charge for their bundles. But consumers also have a limit on the value they place on

the additional features in the bundle. Thus, a competitive price for a bundle, coupled with consumers' value for the added services included in the bundle, will constrain the price the ILECs can charge for stand-alone local service. For example, if a bundle costs \$40 per month, and the features and long distance included in that bundle are worth only \$25 to customers, the presence of a \$40 bundle in the market will constrain the price of stand alone local service to be \$15. Thus, to the same extent that competition is constraining the prices of bundles that include all-distance service and calling features, it is also constraining the price of stand-alone local service.

18. This competition can be expected to have dramatic effects on retail service prices in California. For instance, the national average wireless bill has remained essentially constant over the last four years, even though minutes of use have been growing at 18 percent per year, resulting in a substantial drop in the effective price of wireless calls.¹⁶ In addition, a study prepared by Microeconomic Consulting & Research Associates, Inc. for the National Cable & Telecommunications Association found that the presence of cable telephony providers and the lower prices they charge would result in an annual benefit to consumers nationwide of \$1.3 billion in 2007, climbing to \$3.2 billion in 2011.¹⁷ Clearly, the potential benefits of competition to customers are huge. Similar benefits from competition can be expected in California as well. These benefits will flow to customers who prefer to purchase stand-alone local service as well, as the ILECs' ability to increase the prices for those services will be just as constrained as their ability to raise the price for bundles of services.

19. Taking all these factors into consideration, I conclude that it is unlikely that the ILECs in California will be able to raise their prices for retail local service if the cap is allowed

¹⁶ See CTIA's Mid-Year 2007 Top-Line Survey Results, available online at http://files.ctia.org/pdf/CTIA_Survey_Mid_Year_2007.pdf.

¹⁷ The study can be downloaded online from <http://www.ncta.com/ContentView.aspx?hiddenavlink=true&type=lpubtp1&contentId=3554>.

to expire at the end of 2008. The near-ubiquitous presence of multiple competitors offering substitutes for basic local service will constrain the ILECs' pricing behavior for both stand-alone local service and bundles that include additional services.

Competition will Deter Geographic Deaveraging of Retail Prices

20. The Commission is apparently concerned that the ILECs might geographically deaverage their retail local service prices, either by charging lower prices in the urban centers of their territories and raising their prices to customers in the outlying rural areas or by charging higher prices in less populous towns. Competitive marketplace experience suggests this is not the case.

21. First, for the ILECs to be able to implement such a pricing structure, they would have to be able to sustain the price rise against their competition. However, neither wireless, cable, nor VOIP providers have adopted such a price structure. None of these types of carriers is under any regulatory compulsion to charge a geographically averaged rate, yet they all do. I am aware of no case in which any of these types of carriers has adopted a pricing structure which charges more to customers in more rural areas or in towns with lower populations. This being the case, and to the extent that the ILECs will have to compete with these carriers, it will not be tenable for the ILECs to charge more to rural customers. Thus, there is no reason to believe that the ILECs would even try to adopt such a pricing structure, let alone conclude that they could maintain such a structure if they adopted it.

22. In addition, the ILECs – and all competitors - have a strong incentive to keep the price for getting on the network low. Unless the customer is on the network, it is not possible to sell him or her further services. Every carrier will try to get the customer onto its network, so the carrier can then sell the customer additional services. In the past, these additional services have been long distance, Caller ID and other calling features, broadband internet service, and access.

With further market development and the advent of competition, we can expect that carriers will offer even more additional services that are not yet even thought of. But it is clear that until the carrier has a customer on its network, it cannot sell those additional services. This will give the carriers an incentive to hold down the price for getting on the network.

23. Thus, I conclude that the ILECs will be very unlikely to geographically deaverage their prices. None of the competing wireless, cable, or VOIP companies has adopted such a price structure despite facing no regulatory constraint to do so. This suggests that there are business reasons for avoiding such a price structure, which will likely apply to the ILECs as well. In addition, even if the ILECs wanted to apply such a price structure, they would be competing with numerous companies without such a price structure, which would severely limit the ILECs' ability to sustain geographically deaveraged prices.

Cost-Based Differences in Prices are Justified

24. Even if the ILECs were able to impose and maintain a price differential between rural and urban portions of its territories, that would not necessarily be an unacceptable outcome. To the extent that it does cost more to provide service to an area, such as an outlying rural area, it is appropriate that prices charged to customers reflect that difference. In that way, customers can make the decision whether the benefits to them of living in a rural area outweigh its costs. Just as urban homeowners have to pay a price for their house that reflects the higher cost of land in an urban area, so should rural telephone customers pay a higher price for service to the extent that it is more costly to serve those customers. Artificially reducing the price of rural telephone service below cost will simply send customers and competitors incorrect signals. This may well reduce competition in rural areas, to the harm of customers in those areas.

25. By the same token, it would harm rural customers if prices were higher than is justified by the cost of serving them. So long as there is sufficient competition, the market can

be expected to ensure that prices align with costs. As discussed above, it is unlikely that the market in California will develop such that the retail prices charged to rural customers will be higher than the prices charged to urban customers. The Commission could help ensure that this would be the case by reminding carriers that it expects such an outcome would be unlikely, and that it would not hesitate to use its ability to investigate if it appeared that unjustified price differences were being imposed.

26. Similarly, there may be some limited areas where the cost of serving customers is high and the competitive prices are high enough to be beyond the ability of customers in those areas to pay. In those situations, the Commission has available Lifeline and other social programs that ensure that affordability is maintained. But it should be unnecessary generally to subsidize an entire network in an area.

27. In fact, attempting to hold the price of local service artificially low via regulatory constraints may well have adverse consequences for the very consumers such a policy is intended to protect. An artificially low price will signal to potential competitive alternative providers of local service that there is little or no profit to be made by serving that area, resulting in less competitive entry. The reduced competition will have at least two harmful effects. First, there will be no competitive pressure on the ILEC to reduce its costs and thus the prices paid by consumers. In addition, the innovative services that carriers would introduce in order to compete will simply not appear. Consumers will ultimately suffer the ill effects of these two results.

Conclusion

28. The Commission is concerned that removing the constraint on local service prices will result in those prices rising unreasonably. However, the same competition that the Commission cited in its decision to relax regulation of retail prices can be expected to ensure that prices neither rise to unreasonable levels nor are unreasonably deaveraged geographically. The

Commission should not adopt any additional constraint on basic local service prices after the freeze expires at the end of 2008. This will ensure that consumers in California are faced with basic local service prices that reflect economic costs, that competitors are given the proper signals on where to invest, and is not likely to result in unreasonable increases in basic local service prices.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that, as to the matters stated herein as opinions or on information and belief, I believe them to be true.

Executed at Reston, Virginia, on November 9, 2007.

_____/s/
Chris Frentrup

ATTACHMENT

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PROFESSIONAL EXPERIENCE

Director, Senior Economist –Sprint Nextel

2006-Present

Develop Sprint Nextel policy regarding universal service, interconnection, and regulation of incumbent local exchange carriers. Provide financial analyses in support of these policies. Assist advocates in the preparation of testimony for state public utility commissions, the Federal Communications Commission, and other government agencies.

Economist –MiCRA

2003 - 2006

Estimated the cost of providing competing local telephone service and prepared testimony for use in proceedings before several state utility commissions and the FCC. Assessed cost savings in several mergers.

Senior Economist –MCI

1994 - 2003

Senior economist developing MCI public policy in several proceedings before the Federal Communications Commission - price cap regulation, universal service reform, access reform, Bell Company entry into long distance, pricing of unbundled network elements. Duties included briefing business units and company executives on effect of Commission rulings, developing models and analyses of local exchange company costs in support of MCI's policy positions, and critiquing competing models and analyses. Presented MCI's positions orally and in writing before the FCC.

Industry Economist – Federal Communications Commission

1987 - 1994

Chief economist reviewing cost justification for local exchange company (LEC) access tariffs. Lead economist on LEC Price Cap Task Force, which developed initial LEC price cap plan. Developed study used by Commission to set productivity factor for LEC price caps. Responsible for initial implementation of LEC price cap rules. Advised Commission on implementation of access charge reforms, including expanded interconnection and local transport restructure. Developed statistical methodologies used to review annual access filings for rate of return carriers

Economist - AT&T**1985 - 1987**

Developed econometric models used to forecast demand for AT&T's primary residential and business services. Explained forecasts to business units.

ADDITIONAL EXPERIENCE

- Consultant, Criterion, Inc. 1985
- Visiting Assistant Professor in Economics, University of Texas at Dallas 1984-1985
- Economist, Bureau of Labor Statistics 1980-1981
- Tax Examiner, Internal Revenue Service 1974-1980

EDUCATION

- PhD - Economics, Texas A&M University **1984**
- Bachelor of Arts - Philosophy, University of Texas - Austin **1976**